

6

Aggregation of Income, Set-Off And Carry Forward of Losses

Learning Objectives

After studying this chapter, you would be able to understand –

- ◆ the methodology of set-off / carry-forward and set-off of losses
- ◆ about inter-source adjustments and the cases where inter-source adjustment is not permitted
- ◆ about inter-head adjustments and the cases where inter-head adjustment is not permitted
- ◆ the conditions to be satisfied for carry forward and set-off of loss from house property
- ◆ the conditions to be satisfied for carry forward and set-off of business loss and speculation business loss
- ◆ the conditions to be satisfied for carry forward and set-off of business loss and unabsorbed depreciation in certain cases of amalgamation, demerger etc.
- ◆ the manner of inter-source and inter-head set-off in case of capital losses
- ◆ the maximum period for which different losses can be carried forward
- ◆ treatment of unabsorbed depreciation and business loss, where there is a change in the constitution of the firm
- ◆ treatment of unabsorbed depreciation and business loss in the case of closely held companies
- ◆ the order of set-off of losses

1. Aggregation of Income

In certain cases, some amounts are deemed as income in the hands of the assessee though they are actually not in the nature of income. These cases are contained in sections 68, 69, 69A, 69B, 69C and 69D. These are discussed in detail in Chapter 1. The Assessing Officer may require the assessee to furnish explanation in such cases. If the assessee does not offer any explanation or the explanation offered by the assessee is not satisfactory, the amounts referred to in these sections would be deemed to be the income of the assessee. Such amounts have to be aggregated with the assessee's income.

2. Concept of set-off and carry forward of losses

Specific provisions have been made in the Income-tax Act, 1961 for the set-off and carry forward of losses. In simple words, "Set-off" means adjustment of losses against the profits from another source/head of income in the same assessment year. If losses cannot be set-off in the same year due to inadequacy of eligible profits, then such losses are carried forward to the next assessment year for adjustment against the eligible profits of that year. The maximum period for which different losses can be carried forward for set-off has been provided in the Act.

3. Inter source adjustment [Section 70]

(i) Under this section, the losses incurred by the assessee in respect of one source shall be set-off against income from any other source under the same head of income, since the income under each head is to be computed by grouping together the net result of the activities of all the sources covered by that head. In simpler terms, loss from one source of income can be adjusted against income from another source, both the sources being under the same head.

Example 1: Loss from one house property can be set off against the income from another house property.

Example 2: Loss from one business, say textiles, can be set off against income from any other business, say printing, in the same year as both these sources of income fall under one head of income. Therefore, the loss in one business may be set-off against the profits from another business in the same year.

(ii) Inter-source set-off, however, is not permissible in the following cases -

(a) Long-term capital loss

- (1) Where the net result in respect of any short term capital asset is a loss, such loss shall be allowed to be set-off against income, if any, for that assessment year under the head "capital gains" in respect of any other capital asset, and
- (2) Where the net result in respect of any long-term capital asset is a loss, such loss shall be allowed to be set-off against income, if any, for that assessment year under the head "capital gains" in respect of any other asset not being a short-term capital asset.

Thus, short-term capital loss is allowed to be set off against both short-term capital gain and long-term capital gain. However, long-term capital loss can be set-off only against long-term capital gain and not short-term capital gain.

- (b) **Speculation loss** - A loss in speculation business can be set-off only against the profits of any other speculation business and not against any other business or professional income. However, losses from other business can be adjusted against profits from speculation business.

- (c) Loss from the activity of owning and maintaining race horses - See section 74A(3) in para 13 of this chapter.
- (iii) It must be noted that loss from an exempt source cannot be set-off against profits from a taxable source of income. For example, long-term capital loss on sale of shares sold through a recognized stock exchange cannot be set-off against long-term capital gains on sale of land.

4. Inter head adjustment [Section 71]

Loss under one head of income can be adjusted or set off against income under another head. However, the following points should be considered:

- (i) Where the net result of the computation under any head of income (other than 'Capital Gains') is a loss, the assessee can set-off such loss against his income assessable for that assessment year under any other head, including 'Capital Gains'.
- (ii) Where the net result of the computation under the head "Profits and gains of business or profession" is a loss, such loss cannot be set off against income under the head "Salaries".
- (iii) Where the net result of computation under the head 'Capital Gains' is a loss, such capital loss cannot be set-off against income under any other head.
- (iv) Speculation loss and loss from the activity of owning and maintaining race horses cannot be set off against income under any other head.

Illustration 1

Mr. A submits the following particulars pertaining to the A.Y. 2015-16:

Particulars	₹
Income from salary	4,00,000
Loss from self-occupied property	(-) 70,000
Business loss	(-) 1,00,000
Bank interest (FD) received	80,000

Compute the taxable income of Mr. A for the A.Y. 2015-16.

Solution

Computation of taxable income of Mr. A for the A.Y. 2015-16

Particulars	Amount (₹)	Amount (₹)
Income from salary	4,00,000	3,30,000
Income from house property	(-) 70,000	
Business income	(-) 1,00,000	

6.4 Income-tax

Income from other sources (interest on fixed deposit with bank)	80,000	
Business loss to be carried forward	(-) 20,000	-
Gross total income [See Note below]		3,30,000
Less: Deduction under Chapter VIA		Nil
Taxable income		3,30,000

Note: Gross Total Income includes salary income of ₹ 3,30,000 after adjusting house property loss. Business loss of ₹ 1,00,000 is set off against bank interest of ₹ 80,000 and remaining business loss of ₹ 20,000 will be carried forward as it cannot be set off against salary income.

5. Set-off and carry forward of loss from house property [Section 71B]

- (i) In any assessment year, if there is a loss under the head 'Income from house property', such loss will first be set-off against income from any other head during the same year.
- (ii) If such loss cannot be so set-off, wholly or partly, the unabsorbed loss will be carried forward to the following assessment year to be set-off against income under the head 'Income from house property'.
- (iii) The loss under this head is allowed to be carried forward upto 8 assessment years immediately succeeding the assessment year in which the loss was first computed.
- (iv) For example, loss from one house property can be adjusted against the profits from another house property in the same assessment year. Any loss under the head 'Income from house property' can be set off against any income under any other head in the same assessment year. However, if after such set off, there is still any loss under the head "Income from house property", then the same shall be carried forward to the next year.
- (v) It is to be remembered that once a particular loss is carried forward, it can be set off only against the income from the same head in the forthcoming assessment years.

6. Carry forward and set-off of business losses [Sections 72 & 80]

Under the Act, the assessee has the right to carry forward the loss in cases where such loss cannot be set-off due to the absence or inadequacy of income under any other head in the same year. The loss so carried forward can be set-off against the profits of subsequent previous years.

Section 72 covers the carry forward and set-off of losses arising from a business or profession.

Conditions

The assessee's right to carry forward business losses under this section is, however, subject to the following conditions:-

- (i) The loss should have been incurred in business, profession or vocation.
- (ii) The loss should not be in the nature of a loss in the business of speculation.
- (iii) The loss may be carried forward and set-off against the income from business or profession though not necessarily against the profits and gains of the same business or profession in which the loss was incurred. However, a loss carried forward cannot, under

any circumstances, be set-off against the income from any head other than "Profits and gains of business or profession".

- (iv) The loss can be carried forward and set off only against the profits of the assessee who incurred the loss. That is, only the person who has incurred the loss is entitled to carry forward or set off the same. Consequently, the successor of a business cannot carry forward or set off the losses of his predecessor except in the case of succession by inheritance.
- (v) A business loss can be carried forward for a maximum period of 8 assessment years immediately succeeding the assessment year in which the loss was incurred.
- (vi) As per section 80, the assessee must have filed a return of loss under section 139(3) in order to carry forward and set off a loss. In other words, the non-filing of a return of loss disentitles the assessee from carrying forward the loss sustained by him. Such a return should be filed within the time allowed under section 139(1). However, this condition does not apply to a loss from house property carried forward under section 71B and unabsorbed depreciation carried forward under section 32(2).

Illustration 2

Mr. B, a resident individual, furnishes the following particulars for the P.Y. 2014-15:

<i>Particulars</i>	<i>₹</i>
<i>Income from salary (Net)</i>	<i>45,000</i>
<i>Income from house property</i>	<i>(24,000)</i>
<i>Income from business – non-speculative</i>	<i>(22,000)</i>
<i>Income from speculative business</i>	<i>(4,000)</i>
<i>Short-term capital gains</i>	<i>(25,000)</i>
<i>Long-term capital gains</i>	<i>19,000</i>

What is the total income chargeable to tax for the A.Y. 2015-16?

Solution

The total income chargeable to tax for the A.Y. 2015-16 is calculated as under:

Particulars	Amount (₹)	Amount (₹)
Income from salaries	45,000	21,000
Income from house property	(24,000)	
Profits and gains of business and profession		
Business loss to be carried forward [Note 1]	(22,000)	
Speculative loss to be carried forward [Note 2]	(4,000)	

6.6 Income-tax

Capital Gains		
Long term capital gain	19,000	
Short term capital loss	(25,000)	
Short term capital loss to be carried forward [Note 3]	(6,000)	
Taxable income		21,000

Note 1: Business loss cannot be set-off against salary income. Therefore, loss of ₹ 22,000 from the non-speculative business cannot be set off against the income from salaries. Hence, such loss has to be carried forward to the next year for set-off against business profits, if any.

Note 2: Loss of ₹ 4,000 from the speculative business can be set off only against the income from the speculative business. Hence, such loss has to be carried forward.

Note 3: Short term capital loss can be set off against both short term capital gain and long term capital gain. Therefore, short term capital loss of ₹ 25,000 can be set-off against long-term capital gains to the extent of ₹ 19,000. The balance short term capital loss of ₹ 6,000 cannot be set-off against any other income and has to be carried forward to the next year for set-off against capital gains, if any.

7. Carry forward and set-off of accumulated business losses and unabsorbed depreciation in certain cases of Amalgamation/Demerger, etc. [Section 72A]

(i) **Amalgamation** - This section applies where there has been an amalgamation of –

- (1) a company owning an industrial undertaking or a ship or a hotel with another company or an amalgamation of a banking company with a specified bank; or
- (2) public sector companies engaged in the business of operation of aircrafts.

It provides that the accumulated loss and unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or depreciation, as the case may be, of the amalgamated company for the previous year in which the amalgamation took place. Other provisions of the Act relating to set off and carry forward shall also apply accordingly.

Conditions for availing benefit under this section

(1) Conditions to be fulfilled by the amalgamating company

- (i) The amalgamating company should have been engaged in the business, in which the accumulated loss occurred or depreciation remains unabsorbed, for 3 or more years.
- (ii) The amalgamating company has held continuously as on the date of amalgamation, at least 3/4th of the book value of the fixed assets held by it, 2 years prior to the date of amalgamation.

(2) Conditions to be fulfilled by the amalgamated company

- (i) The amalgamated company should hold at least 3/4th in the book value of fixed assets of the amalgamating company acquired as a result of amalgamation for a minimum period of 5 years from the effective date of amalgamation.
- (ii) The amalgamated company continues the business of the amalgamating company for at least 5 years.
- (iii) The amalgamated company must also fulfill such other conditions prescribed under Rule 9C for the revival of the business of the amalgamating company or to ensure that the amalgamation is for genuine business purpose -
 - (1) The amalgamated company shall achieve the level of production of at least 50% of the installed capacity (capacity as on the date of amalgamation) of the said undertaking before the end of 4 years from the date of amalgamation and continue to maintain the said minimum level of production till the end of 5 years from the date of amalgamation. Central Government has the power to modify this requirement on an application made by the amalgamated company.
 - (2) The amalgamated company shall furnish to the Assessing Officer a certificate in the prescribed form verified by a Chartered Accountant in this regard.

In case the above specified conditions are not fulfilled, that part of carry forward of loss and unabsorbed depreciation remaining to be utilized by the amalgamated company shall lapse and such loss or depreciation as has been set-off shall be treated as the income in the year in which there is a failure to fulfill the conditions.

(ii) Demerger - Where there has been a demerger of an undertaking, the accumulated loss and the unabsorbed depreciation directly relatable to the undertaking transferred by the demerged company to the resulting company shall be allowed to be carried forward and set off in the hands of the resulting company.

If the accumulated loss or unabsorbed depreciation is not directly relatable to the undertaking, the same will be apportioned between the demerged company and the resulting company in the same proportion in which the value of the assets have been transferred.

The Central Government is empowered to notify such conditions as it considers necessary to ensure that the demerger or amalgamation is for genuine business purpose.

(iii) Re-organisation of business [Section 72A(6)]: In case of re-organisation of business, whereby a firm is succeeded by a company as per the provisions of section 47(xiii), or a sole proprietary concern is succeeded by a company as per the provisions of section 47(xiv), then the accumulated business loss and the unabsorbed depreciation of the firm / proprietary concern, as the case may be, shall be deemed to be the loss or depreciation allowance of the

successor company for the previous year in which the business re-organisation took place. Other provisions of the Act relating to set-off and carry forward will apply accordingly.

However, this facility will not be available if it is found that any of the conditions laid down in the corresponding sub-sections (xiii) and (xiv) of section 47 have not been complied with. In such case, the set-off of loss or allowance of depreciation made in any previous year in the hands of the successor company shall be deemed to be the income of the company chargeable to tax in the year in which the conditions have been violated.

(iv) Conversion of a company into LLP [Section 72A(6A)]: The successor LLP would be allowed to carry forward and set-off the business loss and unabsorbed depreciation of the predecessor company. However, if the entity fails to fulfill the conditions specified in section 47(xiiib), the benefit of set-off of business loss/unabsorbed depreciation availed by the LLP would be deemed to be the profits and gains of the LLP chargeable to tax in the previous year in which the LLP fails to fulfill any of the conditions.

Meanings of certain terms

“Accumulated loss” means so much of the loss of the predecessor firm or the proprietary concern or the amalgamating company or the demerged company, as the case may be, under the head “Profit and gains of business or profession” (not being a loss sustained in a speculation business) which such predecessor firm or the proprietary concern or amalgamating company or demerged company, would have been entitled to carry forward and set off under the provisions of section 72 if the re-organisation of business or amalgamation or demerger had not taken place.

“Unabsorbed depreciation” means so much of the allowance for depreciation of the predecessor firm or the proprietary concern or the amalgamating company or the demerged company, as the case may be, which remains to be allowed and which would have been allowed to the predecessor firm or the proprietary concern or amalgamating company or demerged company, as the case may be, under the provisions of this Act, if the re-organisation of business or amalgamation or demerger had not taken place.

“Industrial undertaking” means any undertaking which is engaged in -

- (i) the manufacture or processing of goods;
- (ii) the manufacture of computer software;
- (iii) the business of generation or distribution of electricity or any other form of power;
- (iv) providing telecommunication services, whether basic or cellular, including radio paging, domestic satellite service, network of trunking, broad band network and internet services.
- (v) mining;
- (vi) the construction of ships, aircraft or rail systems.

“Specified bank” means the State Bank of India (SBI) constituted under the SBI Act, 1955 or a subsidiary bank as defined in the SBI (Subsidiary Banks) Act, 1959 or a corresponding new bank constituted under section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 or under section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980.

8. Set-off of losses of a banking company against the profit of a banking institution under a scheme of amalgamation [Section 72AA]

(i) This section provides for carry forward and set off of accumulated loss and unabsorbed depreciation allowance of a banking company against the profits of a banking institution under a scheme of amalgamation sanctioned by the Central Government.

(ii) Where a banking company has been amalgamated with a banking institution under a scheme sanctioned and brought into force by the Central Government under section 45(7) of the Banking Regulation Act, 1949, the accumulated loss and unabsorbed depreciation of the amalgamating banking company shall be deemed to be the loss or the allowance for depreciation of the banking institution for the previous year in which the scheme of amalgamation is brought into force, and all the provisions contained in the Income-tax Act, 1961, relating to set off and carry forward of loss and unabsorbed depreciation shall apply accordingly.

(iii) The *Explanation* to this section defines the expressions “accumulated loss”, “banking company”, “banking institution” and “unabsorbed depreciation” as follows –

- (a) “accumulated loss” means so much of the loss of the amalgamating banking company under the head “Profits and gains of business or profession” (not being a loss sustained in a speculation business) which such amalgamating banking company, would have been entitled to carry forward and set-off under the provisions of section 72 if the amalgamation had not taken place;
- (b) “banking company” shall have the same meaning assigned to it in clause (c) of section 5 of the Banking Regulation Act, 1949;
- (c) “banking institution” shall have the same meaning assigned to it in sub-section (15) of section 45 of the Banking Regulation Act, 1949;
- (d) “unabsorbed depreciation” means so much of the allowance for depreciation of the amalgamating banking company which remains to be allowed and which would have been allowed to such banking company if the amalgamation had not taken place.

9. Provisions relating to carry forward and set off of accumulated loss and unabsorbed depreciation in business reorganisation of co-operative banks [Section 72AB]

(i) Under this section, in a case where the amalgamation has taken place during the previous year, set-off of accumulated loss and the unabsorbed depreciation of the predecessor co-operative bank will be allowed in the hands of the successor co-operative bank as if the amalgamation had not taken place. All the other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation would apply accordingly.

(ii) The benefit of carry-forward and set-off of accumulated losses under this section would be allowed only on fulfillment of the following conditions -

(a) Conditions to be fulfilled by the predecessor co-operative bank

- (1) It should have been engaged in the business of banking for three or more years; and
- (2) It has held at least three-fourths of the book value of fixed assets as on the date of the business reorganisation, continuously for two years prior to the date of business reorganisation;

(b) Conditions to be fulfilled by the successor co-operative bank

- (1) It should hold at least three-fourths of the book value of fixed assets of the predecessor co-operative bank acquired through business reorganisation, continuously for a minimum period of five years immediately succeeding the date of business reorganisation;
- (2) It continues the business of the predecessor co-operative bank for a minimum period of five years from the date of business reorganisation; and
- (3) It fulfils such other conditions as may be prescribed to ensure the revival of the business of the predecessor co-operative bank or to ensure that the business reorganisation is for genuine business purpose.

(iii) The amount of set-off of the accumulated loss and unabsorbed depreciation allowable to the resulting co-operative bank has to be calculated in the following manner -

- (1) **In a case where the whole of the amount of such loss or unabsorbed depreciation is directly relatable to the undertakings transferred to the resulting co-operative bank** - the entire accumulated loss or unabsorbed depreciation of the demerged co-operative bank is allowed to be set-off.
- (2) **In a case where the accumulated loss or unabsorbed depreciation is not directly relatable to the undertakings transferred to the resulting co-operative bank** - the amount which bears the same proportion to the accumulated loss or unabsorbed

depreciation of the demerged co-operative bank as the assets of the undertaking transferred to the resulting co-operative bank bears to the assets of the demerged co-operative bank.

For example, if A Co.op Bank is the demerged co-operative bank and B Co. op Bank is the resulting co-operative bank, the amount of set-off of the accumulated loss and unabsorbed depreciation allowable to B Co-op. bank would be –

$$\text{Unabsorbed business loss/depreciation of A Co - Op bank} \times \frac{\text{Assets of the undertaking transferred to B Co - op bank}}{\text{Assets of A Co - op bank}}$$

(iv) The Central Government may specify other conditions by notification in the Official Gazette as it considers necessary, to ensure that the business reorganisation is for genuine business purposes.

(v) The period commencing from the beginning of the previous year and ending on the date immediately preceding the date of business reorganisation, and the period commencing from the date of such business reorganisation and ending with the previous year shall be deemed to be two different previous years for the purposes of set off and carry forward of loss and allowance for depreciation.

For example, if the date on which business re-organisation took place is 1.11.2014, then the period between 1.4.2014 and 31.10.2014 and the period between 1.11.2014 and 31.3.2015 would be deemed to be two different previous years for the purposes of set-off and carry forward of unabsorbed business losses and depreciation.

(vi) In a case where the conditions specified in (ii) above or notified under (iv) above are not complied with, the set-off of accumulated loss or unabsorbed depreciation allowed in any previous year to the successor co-operative bank shall be deemed to be the income of the successor co-operative bank chargeable to tax for the year in which the conditions are not complied with.

(vii) Accumulated loss means so much of loss of the amalgamating co-operative bank or the demerged co-operative bank, as the case may be, under the head "Profits and gains of business or profession" (not being a loss sustained in a speculation business) which such amalgamating co-operative bank or the demerged co-operative bank, would have been entitled to carry forward and set-off under the provisions of section 72 as if the business reorganisation had not taken place.

(viii) Unabsorbed depreciation means so much of the allowance for depreciation of the amalgamating co-operative bank or the demerged co-operative bank, as the case may be, which remains to be allowed and which would have been allowed to such bank as if the business reorganisation had not taken place.

10. Losses in Speculation Business [Section 73]

(i) The meaning of the expression 'speculative transaction' as defined in section 43(5) and the treatment of income from speculation business has already been discussed under the head "Profits and gains of business or profession".

(ii) Since speculation is deemed to be a business distinct and separate from any other business carried on by the assessee, the losses incurred in speculation can be neither set off in the same year against any other non-speculation income nor be carried forward and set off against other income in the subsequent years.

(iii) Therefore, if the losses sustained by an assessee in a speculation business cannot be set-off in the same year against any other speculation profit, they can be carried forward to subsequent years and set-off only against income from any speculation business carried on by the assessee.

(iv) The loss in speculation business can be carried forward only for a maximum period of 4 years from the end of the relevant assessment year in respect of which the loss was computed. Loss from the activity of trading in derivatives, however, is not to be treated as speculative loss.

(v) The *Explanation* to this section provides that where any part of the business of a company consists in the purchase and sale of the shares of other companies, such a company shall be deemed to be carrying on speculation business to the extent to which the business consists of the purchase and sale of such shares.

However, this deeming provision does not apply to the following companies –

- (1) A company whose gross total income consists of mainly income chargeable under the heads "Interest on securities", "Income from house property", "Capital gains" and "Income from other sources";
- (2) A company, the principal business of which is –
 - (i) ***the business of trading in shares; or***
 - (ii) the business of banking; or
 - (iii) the granting of loans and advances.

Thus, these companies would be exempted from the operation of this *Explanation*. Accordingly, if these companies carry on the business of purchase and sale of shares of other companies, they would not be deemed to be carrying on speculation business.

11. Carry forward & set off of losses by specified businesses [Section 73A]

- (i) Any loss computed in respect of the specified business referred to in section 35AD shall be set off only against profits and gains, if any, of any other specified business.
- (ii) The unabsorbed loss, if any, will be carried forward for set off against profits and gains of any specified business in the following assessment year and so on.
- (iii) There is no time limit specified for carry forward and set-off and therefore, such loss can be carried forward indefinitely for set-off against income from specified business.

Note - The loss of an assessee claiming deduction under section 35AD in respect of a specified business can be set-off against the profit of another specified business under section 73A, irrespective of whether the latter is eligible for deduction under section 35AD. An assessee can, therefore, set-off the losses of a hospital or hotel which begins to operate after 1st April, 2010 and which is eligible for deduction under section 35AD, against the profits of the existing business of operating a hospital (with atleast 100 beds for patients) or a hotel (of two-star or above category), even if the latter is not eligible for deduction under section 35AD.

12. Losses under the head 'Capital Gains' [Section 74]

Section 74 provides that where for any assessment year, the net result under the head 'Capital gains' is short term capital loss or long term capital loss, the loss shall be carried forward to the following assessment year to be set off in the following manner:

- (i) Where the loss so carried forward is a short term capital loss, it shall be set off against any capital gains, short term or long term, arising in that year.
- (ii) Where the loss so carried forward is a long term capital loss, it shall be set off only against long term capital gain arising in that year.
- (iii) Net loss under the head capital gains cannot be set off against income under any other head.
- (iv) Any unabsorbed loss shall be carried forward to the following assessment year up to a maximum of 8 assessment years immediately succeeding the assessment year for which the loss was first computed.

Illustration 3

During the P.Y. 2014-15, Mr. C has the following income and the brought forward losses:

Particulars	₹
Short term capital gains on sale of shares	1,50,000
Long term capital loss of A.Y. 2013-14	(96,000)

Short term capital loss of A.Y.2014-15	(37,000)
Long term capital gain	75,000

What is the capital gain taxable in the hands of Mr. C for the A.Y.2015-16?

Solution

The capital gains taxable are as under:

Particulars	₹	₹
Short term capital gains on sale of shares	1,50,000	1,13,000
Less: Brought forward short term capital loss of the A.Y.2014-15	(37,000)	
Long term capital gain	75,000	Nil
Less: Brought forward long term capital loss of A.Y.2013-14 [See Note below]	(75,000)	
Taxable short-term capital gains		1,13,000

Note: Long-term capital loss cannot be set off against short-term capital gain. Hence, the unadjusted long term capital loss of A.Y.2013-14 of ₹ 21,000 (i.e. ₹ 96,000 – ₹ 75,000) has to be carried forward to the next year to be set-off against long-term capital gains of that year.

13. Losses from the activity of owning and maintaining race horses [Section 74A(3)]

- (i) According to provisions of section 74A(3), the losses incurred by an assessee from the activity of owning and maintaining race horses cannot be set-off against the income from any other source other than the activity of owning and maintaining race horses.
- (ii) Such loss can be carried forward for a maximum period of 4 assessment years for being set-off against the income from the activity of owning and maintaining race horses in the subsequent years.
- (iii) For this purpose, the "amount of loss incurred by the assessee in the activity of owning and maintaining race horses" means the amount by which such income by way of stake money falls short of the amount of revenue expenditure incurred by the assessee for the purpose of maintaining race horses. i.e. Loss = Stake money – revenue expenditure for the purpose of maintaining race horses.
- (iv) Further, the expression 'horse race' means a horse race upon which wagering or betting may be lawfully made.
- (v) "Income by way of stake money" means the gross amount of prize money received on a race horse or race horses by the owner thereof on account of the horse or horses or any one or more of the horses winning or being placed second or in any lower position in horse races.

Illustration 4

Mr. D has the following income for the P.Y. 2014-15 -

Particulars	₹
Income from the activity of owning and maintaining the race horses	75,000
Income from textile business	85,000
Brought forward textile business loss	50,000
Brought forward loss from the activity of owning and maintaining the race horses (relating to A.Y.2012-13)	96,000

What is the taxable income in the hands of Mr. D for the A.Y. 2015-16?

Solution

The taxable income is calculated as under:

Particulars	₹	₹
Income from the activity of owning and maintaining race horses	75,000	
Less: Brought forward loss from the activity of owning and maintaining race horses	<u>96,000</u>	
Loss from the activity of owning and maintaining race horses to be carried forward to A.Y.2016-17	<u>(21,000)</u>	
Income from textile business	85,000	
Less: Brought forward business loss from textile business.	50,000	35,000
Taxable business income		35,000

Note: Loss from the activity of owning and maintaining race horses cannot be set-off against any other source/head of income.

14. Carry forward and set-off of losses in case of change in constitution of firm or succession [Section 78]

- (i) Where there is a change in the constitution of a firm, so much of the loss proportionate to the share of a retired or deceased partner remaining unabsorbed, shall not be allowed to be carried forward by the firm. However, unabsorbed depreciation can be carried forward.
- (ii) Where any person carrying on any business or profession has been succeeded in such capacity by another person otherwise than by inheritance, such other person shall not be allowed to carry forward and set off against his income, any loss incurred by the predecessor.
- (iii) Where there is a succession by inheritance, the legal heirs (assessable as BOI) are

entitled to set-off the business loss of the predecessor. Such carry forward and set-off is possible even if the legal heirs constitute themselves as a partnership firm. In such a case, the firm can carry forward and set-off the business loss of the predecessor.

15. Carry forward and set-off of losses in case of closely held companies [Section 79]

(i) Where in any previous year, there has been a change in the shareholding of a company in which the public are not substantially interested, any unabsorbed loss of the company shall be allowed to be carried forward and set off against the income of the previous year only if the beneficial shareholders of at least 51% of the voting power on the last day of the previous year remained the same as on the last day of the year or years in which the loss was incurred.

(ii) However, this restriction shall not apply in the following two cases:

- (1) where a change in the voting power is consequent upon the death of a shareholder or on account of transfer of shares by way of gift by a shareholder to his relative; and
 - (2) where the change in shareholding takes place in an Indian company, being a subsidiary of a foreign company, as a result of amalgamation or demerger of the foreign company. However, this is subject to the condition that 51% of the shareholders of the amalgamating/demerged company continue to be shareholders of the amalgamated/resulting company.
- (iii) The provisions of this section are applicable only in respect of carry forward of losses and not in respect of carry forward of unabsorbed depreciation, which is covered by section 32(2).

16. Order of set-off of losses

As per the provisions of section 72(2), brought forward business loss is to be set-off before setting off unabsorbed depreciation. Therefore, the order in which set-off will be effected is as follows -

- (a) Current year depreciation / Current year capital expenditure on scientific research and current year expenditure on family planning, to the extent allowed.
- (b) Brought forward loss from business/profession [Section 72(1)]
- (c) Unabsorbed depreciation [Section 32(2)]
- (d) Unabsorbed capital expenditure on scientific research [Section 35(4)].
- (e) Unabsorbed expenditure on family planning [Section 36(1)(ix)]

Illustration 5

Mr. E has furnished his details for the A.Y.2015-16 as under:

Particulars	₹
Income from salaries	1,50,000
Income from speculation business	60,000
Loss from non-speculation business	(40,000)
Short term capital gain	80,000
Long term capital loss of A.Y.2013-14	(30,000)
Winning from lotteries	20,000

What is the taxable income of Mr. E for the A.Y. 2015-16?

Solution

Computation of taxable income of Mr. E for the A.Y.2015-16

Particulars	₹	₹
Income from salaries		1,50,000
Income from speculation business	60,000	
Less : Loss from non-speculation business	(40,000)	20,000
Short-term capital gain		80,000
Winnings from lotteries		20,000
Taxable income		2,70,000

Note: Long term capital loss can be set off only against long term capital gain. Therefore, long term capital loss of ₹ 30,000 has to be carried forward to the next assessment year.

Illustration 6

Compute the gross total income of Mr. F for the A.Y.2015-16 from the information given below –

Particulars	₹
Net income from house property	1,25,000
Income from business (before providing for depreciation)	1,35,000
Short term capital gains on sale of shares	56,000
Long term capital loss from sale of property (brought forward from A.Y.2014-15)	(90,000)
Income from tea business	1,20,000
Dividends from Indian companies carrying on agricultural operations	80,000
Current year depreciation	26,000
Brought forward business loss (loss incurred six years ago)	(45,000)

Solution

The gross total income of Mr. F for the A.Y. 2015-16 is calculated as under:

Particulars	₹	₹
Income from house property		1,25,000
Income from business		
Profits before depreciation	1,35,000	
<i>Less:</i> Current year depreciation	26,000	
<i>Less:</i> Brought forward business loss	45,000	
	64,000	
Income from tea business (40% is business income)	48,000	1,12,000
Income from the capital gains		
Short term capital gains		56,000
Gross Total Income		2,93,000

Note: (1) Dividend from Indian companies is exempt from tax. 60% of the income from tea business is treated as agricultural income and therefore, exempt from tax;

(2) Long-term capital loss can be set-off only against long-term capital gains. Therefore, long-term capital loss of ₹ 90,000 brought forward from A.Y.2014-15 cannot be set-off in the A.Y.2015-16. It has to be carried forward for set-off against long-term capital gains, if any, during A.Y.2016-17.